

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING #95-17**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

Application of the sales and use tax to services provided by [THE TAXPAYER] pursuant to an Agreement for Systems Operations entered into with [THE CUSTOMER].

**SCOPE**

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the department, but applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

**FACTS**

[THE TAXPAYER] has entered into an Agreement for Systems Operations with [THE CUSTOMER]. A subsidiary of [THE TAXPAYER], [COMPANY A], has since taken over [THE TAXPAYER]'s responsibilities under the agreement. This ruling refers to both entities collectively as [THE TAXPAYER/COMPANY A]. Under the terms of the

agreement, [THE TAXPAYER/COMPANY A] agrees to maintain and operate the customer's computer systems, install software upgrades as necessary, provide user training, consultation, and other services as needed. [THE TAXPAYER/COMPANY A] states that no fabrication of computer software of any kind will be performed under the terms of the contract. A copy of the Agreement is attached as an addendum to this letter ruling. A review of the Agreement reveals the following relevant provisions (emphasis added):

#### 4.03 SOFTWARE

a) During the Term of this Agreement, [THE TAXPAYER] will be solely responsible for operating, maintaining and enhancing as necessary all Data Center and Network systems software [THE TAXPAYER/COMPANY A] has represented that maintenance and enhancement under this provision is limited to installment of software upgrades] (including systems utilities software) required to perform the Services, and such systems software will be included as [THE TAXPAYER] Software. [THE TAXPAYER] will provide or obtain upgrades, replacements or additional systems software as [THE TAXPAYER] deems necessary in order to perform the Services in the manner required by this Agreement. All such additions, replacements and upgrades will be at [THE TAXPAYER]'s expense, and will be included as [THE TAXPAYER] Software. Upon the termination or expiration of this Agreement for any reason, [THE TAXPAYER] will transfer to [THE CUSTOMER], or [THE CUSTOMER]'s designee, the licenses it possesses to use such systems software, as provided in Subsection 13.05.

#### 4.04 DATA LINES

[THE TAXPAYER] will provide or obtain upgrades, replacements or additional data line capacity as [THE TAXPAYER] deems necessary in order to perform the Services in the manner required by this Agreement. In addition, in [YEAR] [THE TAXPAYER] will put into service, and provide such capability throughout the Term of this Agreement, a redundant, high-capacity data line between the Data Center and the [TENNESSEE

CITY] point-of-presence (POP) of a second telecommunications provider. All such additions, replacements and upgrades will be at [THE TAXPAYER]'s expenses; provided, however, that [THE CUSTOMER] will reimburse [THE TAXPAYER] for costs incurred by [THE TAXPAYER] for data line capacity outside the State of Tennessee which is more than 500 miles from [TENNESSEE CITY] (except for data line capacity which [THE TAXPAYER] installs for its own benefit, such as the line from [ANOTHER STATE], to the Data Center).

#### 4.06 SYSTEMS OPERATIONS, SUPPORT AND MAINTENANCE

[THE TAXPAYER] will:

- a) operate the Data Center and its installed data processing Machines listed in the Schedules to this Agreement 24 hours a day, 7 days a week, 365 days a year, on either a local or remote basis;
- b) operate the Networks, using Machines and Software, on either a local or remote basis;
- c) provide maintenance services for Machines in the Data Center and Networks. Such maintenance services will be according to the terms and conditions specified in Schedule P;
- d) provide maintenance and maintenance coordination services for machines in the [THE CUSTOMER] [DOCUMENT] Processing Centers (including usage charges) and for the machines located at End User Locations, which machines are listed in Schedules I and N. Such maintenance and coordination services will be provided according to the terms and conditions specified in Schedule P;

#### 4.10 PROGRAMMING SERVICES

[THE TAXPAYER] will:

- a) apply preventive maintenance and program temporary fixes to correct defects in [THE

TAXPAYER] Software running in the Networks or Data Center; and

b) install new versions of releases of, or major modifications to, [THE TAXPAYER] Software in accordance with Subsection 4.08.

#### 4.11 APPLICATION DEVELOPMENT

[THE TAXPAYER] will provide the following equipment, software and services to [THE CUSTOMER], all as further described in Schedule N:

a) Commercial and Installment Loans:

[THE TAXPAYER] will manage and provide:

- 1) delivery, installation (exclusive of Token Ring cabling), set-up and testing of [PERSONAL COMPUTERS] (up to 50 of which will, at [THE CUSTOMER]'s request, be Portable Models), 200 [PRINTERS], plus training and maintenance, all in support of the BancA application; and
- 2) installation and testing of the BancA loan system as well as [THE TAXPAYER] [COMPUTER EQUIPMENT] operating system software on the [COMPUTER EQUIPMENT] specified in Subsection 4.11 a) 1) (including associated project management and systems resources), plus training for such application.

b) Branch Automation (Platform and Teller):

[THE TAXPAYER] will manage and provide:

- 1) delivery, installation (exclusive of Token Ring cabling), set-up and testing of [PERSONAL COMPUTERS], one [PRINTERS] plus training and maintenance;
- 2) installation and testing of the [EQUIPMENT] platform and teller application as well as [THE TAXPAYER] [COMPUTER EQUIPMENT] operating system software on the [COMPUTER EQUIPMENT] specified in Subsection 4.11 b) 1)

(including associated project management and system resources), plus training for such application;

#### 11.02 MAINTENANCE

[THE TAXPAYER] represents and warrants that it will maintain Machines, and all other equipment and machines (including End User Machines) for which it has maintenance responsibilities hereunder, in good operating condition and will undertake all repairs and preventive maintenance in accordance with industry standards and practices as measured by the standards and practices followed by the five largest providers of such maintenance services.

The Agreement was executed effective [DATE] and is scheduled to expire [DATE]. This ruling is applicable to services provided prospectively from June 30, 1994 under the Agreement.

#### **ISSUE**

How will the sales and use tax apply to services provided by [THE TAXPAYER/COMPANY A] Agreement prospectively from June 30, 1994 under the contract?

#### **RULING**

Sales tax will apply to charges for taxable services provided under the agreement. Taxable services which are within the scope of the agreement are as follows:

- a) Installation of computer software or other tangible personal property which remains tangible personal property after installation;
- b) Repair services provided with respect to computer software or other items of tangible personal property.
- c) Charges for a warranty or service contract warranting the repair or maintenance of tangible personal property are also taxable, provided that any repairs to the extent covered by the contract are not also subject to tax;
- d) Telecommunications service provided pursuant to the agreement unless regulated as a private line service by the Public Service Commission.

Other services which are or could be provided under the contract are operation of the equipment, training, and consultation not related to the sale of tangible personal property. These services are not subject to the sales tax.

## **ANALYSIS**

T.C.A. Section 67-6-102 (23)(F) enumerates the following taxable services under the sales tax:

(i) The sale, rental or charges for any rooms, lodgings, or accommodations furnished to transients by any hotel, inn, tourist court, tourist camp, tourist cabin, motel, or any place in which rooms, lodgings or accommodations are furnished to transients for a consideration. The tax does not apply, however, to rooms, lodgings, or accommodations supplied to the same person for a period of ninety (90) continuous days or more;

(ii) Services rendered by persons operating or conducting a garage, parking lot or other place of business for the purpose of parking or storing motor vehicles. The tax does not apply, however, to charges for such services made by the state and its political subdivisions when providing on-street parking space for which charges are collected, or when operating or conducting a garage or parking lot which is unattended and such charges are collected by parking meters;

(iii) The furnishing, for a consideration, of either intrastate or interstate telecommunication services. Only those charges for interstate telecommunication which are originated or received in this state and which are billed or charged to a service address in Tennessee shall be included in the tax base;

(iv) The performing for a consideration of any repair services with respect to any kind of tangible personal property;

(v) The laundering or dry cleaning of any kind of tangible personal property, excluding coin-operated laundry, dry cleaning or car wash facilities, where a charge is made therefor; provided, that the provisions of this subdivision shall not apply to the bathing and grooming of animals until July 1, 1985; and provided further, that notwithstanding any provision of this chapter to the contrary, taxes levied pursuant to this chapter on bathing and grooming of animals shall only be applied to fifteen percent (15%) of the gross charge for such bathing and grooming;

(vi) The installing of tangible personal property which remains tangible personal property after installation where a charge is made for such installation whether or not such installation is made as an incident to the sale thereof and whether or not any tangible personal property is transferred in conjunction with such installation service;

(vii) The enriching of uranium materials, compounds, or products, which is performed on a cost-plus basis or on a “toll enrichment fee” basis;

(viii) The renting or providing of space to a dealer or vendor without a permanent location in this state or to persons who are registered for sales tax at other locations in this state but who are making sales at this location on a less than permanent basis. This subdivision (23)(F)(viii) does not apply to the renting or providing of space to a craft fair, antique mall, or book fair or gun show, if such gun show or book fair is sponsored by a not-for-profit corporation. This subdivision (23)(F)(viii) also does not apply to the renting or providing of space at a flea market or the renting or providing of space at conventions, trade shows, or expositions, if such conventions, trade shows, or expositions do not allow the general public to enter the exhibit area for the purpose of making sales or taking orders for sales; and

(ix) Charges for warranty or service contracts warranting the repair or maintenance of tangible personal property; provided, that any repairs to the extent covered by the contract shall not also be subject to tax;

Under the facts provided it is clear that the installation of computer software is an ongoing service provided under the contract under Agreement Sections 4.03 and 4.10. Since computer software is tangible personal property, the installation thereof is taxable under subdivision (vi) of the statute. Under Agreement Section 4.11 [THE TAXPAYER/COMPANY A] agrees to be responsible for the installation of various items of computer equipment. This is also a taxable installation service under the statute, assuming that these items remain tangible personal property after installation.

Under Agreement Section 4.04 [THE TAXPAYER/COMPANY A] agrees to provide telecommunications services in the form of data lines between certain points. Tennessee defines as a taxable retail sale the furnishing, for a consideration, of telecommunication services. T.C.A. § 67-6-102(22)(F)(iii). Intrastate telecommunication is always taxable, and interstate telecommunication is taxable if it originates or is received in Tennessee and is charged or billed to a service address in Tennessee. *Id.* Telecommunications is defined by statute to mean communication by electric or electronic transmission of impulses including transmission by or through microwaves. T.C.A. § 67-6-102(27)(A), (B). T.C.A. Section 67-6-102 (29) (D) defines the term “telecommunications” not to include “private line service”. “Private line service” is defined by T.C.A. Section 67-6-102(21) as a dedicated line service which is provided to connect two (2) or more specific locations. The Department will recognize exemption as a private line service if the service provided is regulated as a private line service by the Tennessee Public Service Commission. If the telecommunications service provided is not regulated as a private line service then the charges therefor will be subject to tax.

Under Agreement Sections 4.06 and 11.02 [THE TAXPAYER/COMPANY A] warrants the maintenance and repair of certain equipment and machines. Also under Agreement Sections 4.03 and 4.10 [THE TAXPAYER/COMPANY A] appears to warrant the

temporary repair and/or maintenance of certain software items. T.C.A. Section 67-6-102 (23) (F) (ix) imposes the sales tax on all charges for warranty or service contracts warranting the repair or maintenance of tangible personal property. Sales tax will be due on all charges for the warranty contract regardless of the extent of actual repairs or maintenance performed thereunder. Tax will not be due on any charges for repairs actually performed under the taxable warranty.

Any similar installations, repairs, or warranty services provided under other provisions of the referenced agreement would be subject to sales tax.

Operation of the machines, training, and consultation not related to the sale of tangible personal property are not taxable services and would not be subject to the sales tax. [THE TAXPAYER/COMPANY A] represents that no fabrication of software will occur under the Agreement.

Steve Thomas  
Deputy General Counsel

APPROVED: Ruth E. Johnson

DATE: 6/2/95